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IN THE

Supreme Court of the United States

OCTOBER TERM, 1959.

No. 819

COMMERCIAL CREDIT CORPORATION, a corporation,
Petitioner.

vs.

C. WYLIE ALLEN, Trustee in Bankruptcy of Crosstown Motors, Inc.,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

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The Scheffer Press, Inc.—ANdover 3-6850

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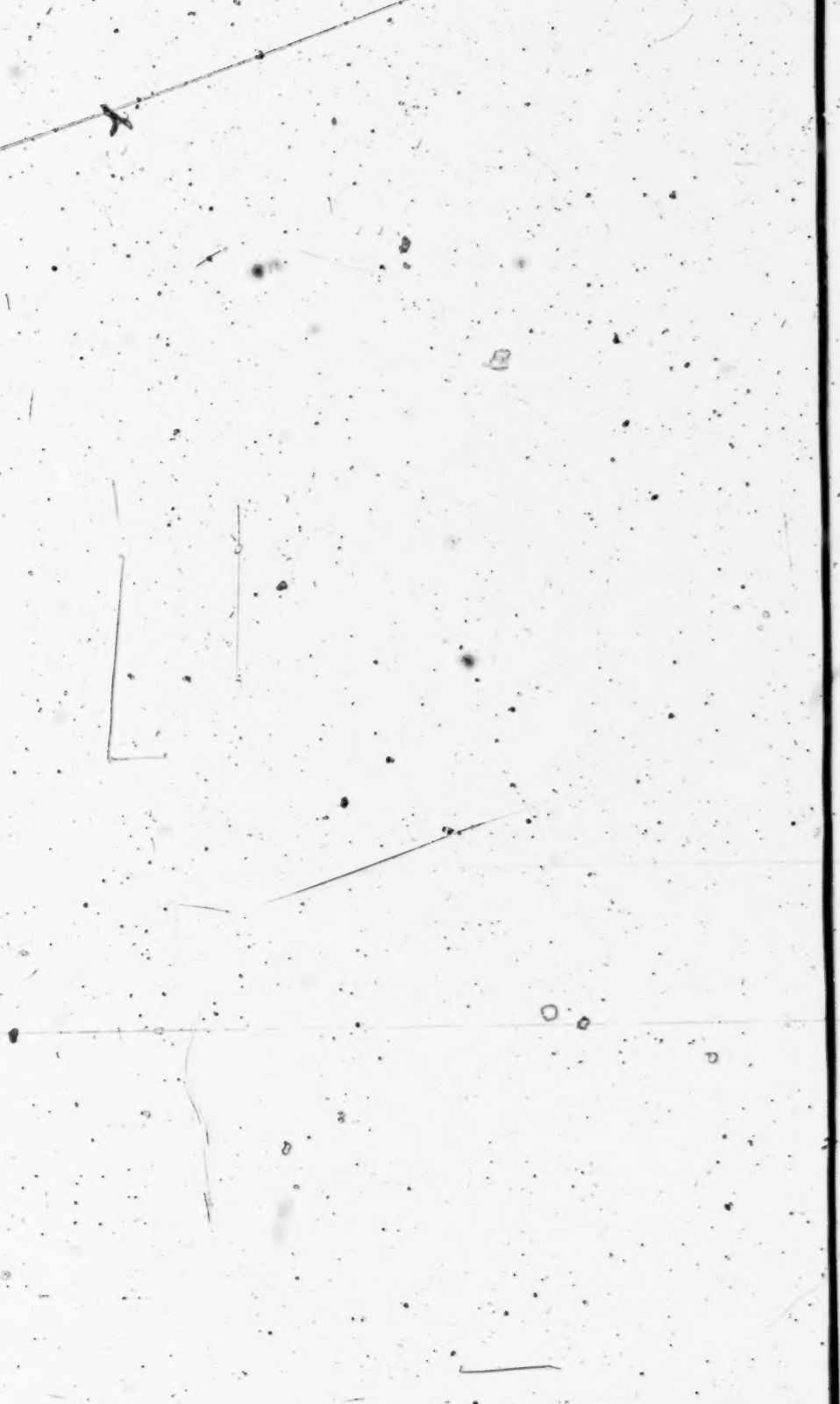

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

To the Honorable Chief Justice and Associate Justices of the Supreme Court of the United States:

I.

The Petitioner prays that a Writ of Certiorari issue to review the decision and judgment of the United States Court of Appeals for the Seventh Circuit, entered in the above entitled cause on October 15, 1959, rehearing denied Dec. 29, 1959.

CITATIONS TO OPINION BELOW.

The memorandum opinion of the Referee in Bankruptcy is unreported. The opinion of the Referee in Bankrutcy was adopted by the District Judge, and has not been reported.

The opinion of the Court of Appeals, printed in Appendix A hereto, *infra* (1a-6a), is reported in 272 F. (2d) 224.

JURISDICTION.

The judgment of the Court of Appeals was entered on October 15, 1959, Appendix B, (7a). Rehearing was denied on December 29, 1959 (Appendix C, 7a).

The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1), 11 U.S.C. § 47.

QUESTIONS PRESENTED FOR REVIEW.

(a) Does section ten (10) of the Illinois Uniform Trust Receipts Act give an Entruster a "security interest" or "lien" on the bankrupt's other assets, where (1) goods held by the bankrupt are duly covered by a trust receipt so as to give entruster a valid "security interest" or "lien" in such goods and, (2) are sold by the trustee and not paid for to the entruster; or does Section ten (10) only give such Entruster a "priority in payment" under the Bankruptcy Act.

(b) If Section ten (10) gives a lien on the other assets is such a lien a "statutory" or a "consensual" lien within the meaning of Section 67 c (2) of the Bankruptcy Act.

(c) Is such "security interest" or "lien" invalid under Sections 60 a or 70 e of the Bankruptcy Act.

STATUTE INVOLVED.

The statutory provisions involved are (1) Section 10 of the Uniform Trust Receipts Act, (Sec. 175, Chap. 121½) Illinois Revised Statutes 1957, State Bar Assn. Edition). (2) Sections, 60a, 67c(2) and 70e of the Bankruptcy Act (Appendix "D", 9a-11a).

STATEMENT.

Crosstown Motors, Inc., (hereinafter referred to as Crosstown), a franchized Ford Dealer, was adjudicated a bankrupt in August 1957, on an involuntary petition. C. Wylie Allen was appointed Receiver (and later Trustee), and as such liquidated the assets of the bankrupt estate and received approximately $45,000.00. Commercial Credit Corporation, a finance company, (hereinafter referred to as Commercial) financed the "floor plan"., *viz.*, new and used cars for Crosstown on trust receipts, and fully complied with all the requirements of the Illinois Uniform Trust Receipts Act. Between July 3, 1957 and July 19th, 1957, and just before bankruptcy, Crosstown sold twenty-five (25) automobiles on which Commercial held valid trust receipts amounting to $50,578.24, used the proceeds of the sale to pay general creditors and payroll and failed to remit the money to Commercial according to the trust receipts and the Illinois Uniform Trust Receipts Act.

Commercial filed a petition asserting a lien on the general assets of the bankrupt in the sum of $50,578.24, for the twenty-five (25) automobiles sold "out of trust" by the bankrupt. The trustee in bankruptcy defended on the ground that the language of Section 10 did not create a lien on the general assets of the bankrupt, but a mere state-created priority invalid under Sec. 64 of the Bankruptcy Act; also, that if Sec. 10 did create a lien it was invalid under Secs. 60a, 67c(2) and Sec. 70e of the Bank-

ruptcy Act. The trustee also counterclaimed, and was upheld on some preferential payments made by bankrupt to Commercial totaling $7,416.67. This part of the lower Court's decision is accepted by Commercial and need not be considered in connection with this petition. Commercial's claim under rights given by Section ten (10) of the Illinois Uniform Trust Receipts Act being $50,578.24, less the preferential payments of $7,416.67.

The matter was heard by the Referee in Bankruptcy who denied the relief sought by Commercial and entered a judgment against Commercial on the Counterclaim of the Trustee in Bankruptcy for the sum of $7,416.67. The Referee in Bankruptcy held that while the *Harpeth Motors* case may have properly interpreted the legislative intent of the Tennessee Legislature in the enactment of Section 10 of the Tennessee Trust Receipt Act that the intent of the Illinois Legislature was not "to create a lien valid in bankruptcy against the rights of the Trustee in Bankruptcy against the general assets of the bankrupt-borrower's assets, but only to create a preference or priority in the distribution of such assets." The Referee further found that such state-created priority would have been valid and enforceable in bankruptcy until the enactment by Congress of the Chandler Act of 1938, but that the revision of Section 64 in 1938, now renders such state-created priority invalid and ineffective. The Referee further held that even if Section 10 of the Uniform Trust Receipts Act had granted a lien that it would be invalid under Sections 60a, 67c(2) and 70e of the Bankruptcy Act.

The District Court affirmed the Referee's findings of fact and conclusions of law, and adopted the Referee's opinion as its own. The Court below affirmed the orders of the District Court in an opinion written by Judge W. Lynn Parkinson just before his physical breakdown and disappearance.

REASONS FOR GRANTING THE WRIT.

(1) The decision of the Court below in the instant case is in direct conflict in its interpretation of Section 10 of the Uniform Trust Receipts Act, with the decision of the Supreme Court of Indiana in the case of *Universal Credit Co.* v. *Citizens State Bank*, 224 Ind. 1; 64 N.E.(2) 28, 168 A.L.R. 352; the Court of Appeals of Tennessee, in the case of *Commerce Union Bank of Nashville* v. *Alexander*, 312 S.W. 2d 611, the Supreme Court of Idaho in the case of *Commercial Credit Corporation* v. *Bosse*, 283 P. 2d 937. Likewise, it is in direct conflict with the District Court decision of *In the Matter of Harpeth Motors, Inc.* (D.C. Tenn. 1935) 135 F.Supp. 863. This latter case has been approved and followed in *Commerce Union Bank of Nashville* v. *Alexander, Supra,* and *James J. English* v. *Universal C.I.T. Corporation*, D.C. So. Dist. of Florida, Miami Division, No. 8929M-Civil, and now pending on appeal by the plaintiff in the U.S. Court of Appeals, Fifth Circuit, No. 18,013. In the latter case oral arguments were made on March 7th, 1960, and a decision should be forthcoming from the Fifth Circuit momentarily. If the Fifth Circuit Court of Appeals should affirm the District Court of Florida, then there would be a direct conflict with the decision of the Seventh Circuit in the instant case and the Fifth Circuit in the *English* v. *Universal C.I.T.* case, *supra.*

The case of *In the Matter of Harpeth Motors, Inc.*, 135 F. Supp. 863, has been approved in 69 *Harvard Law Review*, p. 1343 (1956); 66 *Yale Law Journal* 922. The decision of the court below is wrong, stands by itself, is in direct conflict with the two District Court decisions and three State Court decisions, and should be reversed.

(2) Clearly, the question presented is of importance in the administration of the federal bankruptcy Act. It is of extreme importance to banks, finance companies, and

money lending institutions; it is the lifeblood of the small businessman who must depend on floor plan financing to sustain his business. 99% of all small businessmen would be unable to carry a stock of merchandise without credit from banks or finance companies; only the businessman with excellent credit rating and sufficient cash operating capital could furnish a credit statement sufficiently strong for banks and finance companies to do business with him. Banks and finance companies will be forced to withdraw this type of credit unless the courts or legislatures provide protection. It is a matter of public interest. Unless the decision is reversed it will require the amending of Section 10 of the Uniform Trust Receipts Act, in 35 states and in Puerto Rico. This will not be necessary if this Court reverses the decision and judgment of the Court below, and follows the interpretation of Section 10 as outlined by Judge Miller in the *Harpeth Motors case* and other cases before cited.

(3) The decision of the court below is believed to be erroneous, and, the conflicting decision of *Harpeth Motors, supra,* correct. The *Harpeth Motors* case, as heretofore shown, has been followed in the District Court in Florida and in the State Court of Tennessee; its interpretation of Section 10 has been consistent with the Supreme Courts of Indiana and Idaho. The Harvard and Yale Law Review Articles so completely analyze the pertinent legislation, its history, purposes and the result to be accomplished by the two statutes (Uniform Trust Receipts Act, and the Bankruptcy Act) and the case law, that we have taken the liberty to set forth the 69 Harvard Law Review Article 1343, as Appendix F, 24a-25a, and the 66 Yale Law Journal as Appendix G, 26a-46a.

Judge Parkinson in his opinion stated that the Uniform Trust Receipts Act was adopted by the Illinois Legislature in 1935, some three years before the passage of the Chandler Act in 1938. In 1935, he says, a state-created priority was recognized in Bankruptcy; however, since the passage of the Chandler Act in 1938, the priority provided by Section 10 applies in insolvency proceedings other than bankruptcy, but is void under Section 64 of the Bankruptcy Act now. Such argument and holding is contrary to the facts.

Only ten states had enacted this legislation prior to the 1938 Bankruptcy Amendment, *viz.*: 1. California (1935), 2. Connecticut (1937), 3. Illinois (1935), 4. Indiana (1935), 5. Massachusetts (1936), 6. New Hampshire (1939), 7. New Jersey (1938), 8. New York (1934), 9. Oregon (1935), 10. Tennessee (1937).

After the 1938 Bankruptcy Amendment, the following 25 States enacted the Uniform Trust Receipts Act, *viz.*:

1. Alabama (1949), 2. Alaska (1951), 3. Arizona (1947), 4. Arkansas (1959), 5. Delaware (1947), 6. Florida (1951), 7. Hawaii (1951), 8. Idaho (1950), 9. Maine (1955), 10. Maryland (1941), 11. Michigan (1952), 12. Minnesota (1943), 13. Mississippi (1950), 14. Montana (1945), 15. Nebraska (1949), 16. Nevada (1941), 17. New Mexico (1947), 18. North Dakota (1945), 19. Ohio (1957), 20. South Dakota (1945), 21. Utah (1945), 22. Virginia (1944), 23. Washington (1943), 24. Wisconsin (1953), 25. Wyoming (1947). In addition, Puerto Rico enacted the statute in 1954.

To say that these twenty-six State Legislatures were attempting to create a mere priority, the effectiveness of which the Bankruptcy Act had abolished in 1938, is to attribute to them a collective stupidity hardly justified by the facts. This same argument attributes the same col-

lective stupidity to the many able lawyers who have composed the National Conference of Commissioners on Uniform State Laws. The Uniform Trust Receipts Act has not been withdrawn, amended or revised, as have many of the Uniform Laws because of experience subsequent to their passage. It is quite apparent that the Commissioners, and the 25 state legislatures did not believe the 1938 Bankruptcy Amendment had the effect Judge Parkinson attributed to it. The Referee in Bankruptcy made a mistake; his erroneous decision and lack of understanding of the problem to be remedied by the Uniform Trust Receipts Act and the interpretation of the Act with respect to Bankruptcy Laws is quite apparent. The District Judge (Judge Julius Miner, a recent appointee), adopted the Referee's opinion without affording any chance to argue the matter. Judge Parkinson likewise adopted the Referee's opinion, and it is evident from the opinion, did not understand the results of such a decision on the financial world.

Section 19 of the Uniform Trust Receipts Act (Appendix 10a) provides that it is to be construed uniformly with decisions in other States adopting the Act. The State courts of Indiana, Idaho, and Tennessee, disagreed with Judge Parkinson's opinion; it is, as we have heretofore pointed out, contrary to the *Harpeth Motors* case, *supra,* and the District Court of Florida, through the latter case is now pending on appeal in the Fifth Circuit. 35 State Legislatures enacted the Uniform Trust Receipts Act, and, according to decision below, performed a useless act as far as Section 10 was concerned.

The opinion below disregards the purposes for which the Act was adopted. There is no inconsistency in having a debt which is secured by a lien and one which is also entitled to priority (see Footnote 41 in the note from the Yale Law Journal, Appendix page 40a). The language at the

end of Section 10(b), "and to a priority to the amount of such proceeds or value," indicates that this is intended by the draftsman to add an additional right to what had been expressed in the preceding words.

(4) The most important factor overlooked by the decisions below is the mortal wound inflicted upon the Uniform Trust Receipts Act. *Billions of dollars* have been advanced by banks and finance companies to make it possible for small business men to stay in business. Congressional hearings have filled volumes in an effort to help small businessmen. The 1950 Bankruptcy Amendment, and the many hearings thereon, show that its purpose was:

> "to remove the resultant serious doubts that now exist among banks, factors, and other extenders of credit upon the validity of security taken in good faith and for present value. The present language of the act tends to impede and choke the flow of credit principally to small business men, and the object of the bill is to free its channels.
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> "The resultant confusion has cast grave doubt upon the validity of normal business security, in all of the areas covered by trust receipts • • • factors liens • • • assignments of accounts receivable, etc. (emphasis ours). (*In re Tele-Tone Radio Corporation*, D.C. N.J.) (1955) 133 F. Supp. 739."

The statistics published by the Board of Governors of the Federal Reserve System show that in 1957, on wholesale automobile credit alone $12,004,000,000.00 was financed on trust receipts, in 1958 $9,268,000,000.00; and in the first nine months for 1959, the amount was $10,038,000,000.00. As the population and the automobile sales increase the amount of wholesale, or floor plan financing on trust receipts will increase. Then, too, trust receipt financing

is used to finance dealers in radios, televisions, household appliances, farm equipment, and numerous other items. It is safe to say that the healthy economy of our nation depends upon the steel, oil, and automobile industry, and their allied industries. The decision of the court below takes away the protection that lending agencies so vitally need to engage in this type of financing. Unless this decision is reversed this type of trust receipt financing will be limited only to the large, wealthy, and strong dealers. The Trust Receipts Act was passed to protect the lender against the honest insolvency of the dealer, and it needs a lien superior to later lien claimants and unsecured creditors. That this was the purpose of the Act is crystal clear. Unless such a lien is available to banks and other money lending institutions, the cost of this type of financing would be prohibitive to the dealer. The decision of the court below is a re-hash of the Referee's erroneous deductions and conclusions, based on a total unfamiliarity of purposes of the Trust Receipts Act as pertaining to bankruptcy. Judge Parkinson was not physically able, at the time he wrote his opinion, to give the questions presented considerate study and analysis. His opinion reflected this.

At the time of the hearing before the Referee, the bankrupt estate amounted to approximately $45,000.00. The referee's opinion was concerned with the fact that if Section 10 gave Commercial a lien, there would be little or no estate left for the payment of bankruptcy costs and fees. It is apparent that the lower court's findings were influenced by this fact. However, where, as in the instant case, the ruling affects a volume of business reaching into billions of dollars, then some better reason should be forthcoming for the Court not to follow the *Harpeth Motors* decision. This Court should overrule the findings in the instant case, even if Commercial had

to stand some portion of the costs and fees. It is more important to the financial world and, in particular, small businessmen, to have a correct interpretation of Section 10 of the Trust Receipts Act, than to fight bankruptcy costs and fees.

It is respectfully submitted that the interpretation made by Judge Miller in the *Harpeth case* is far more sound, more desirable, and expressed the true meaning of the Uniform Trust Receipts Act. To accept the decision of the Referee, which furnished the basis for Judge Parkinson's decision, would inflict a mortal wound on the Uniform Trust Receipts Act, destroy an important part of the work of the National Conference of Commissioners on Uniform State Laws, and make it necessary for banks, finance companies and other leading institutions to shoulder the herculean task of amending the Act in 35 States.

CONCLUSION.

For the foregoing reasons, this Petition for Writ of Certiorari should be granted.

Respectfully submitted,

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APPENDIX A.

Opinion of the Court of Appeals.

In The
UNITED STATES COURT OF APPEALS
For The Seventh Circuit

No. 12610

October 15, 1959

Before MAJOR, SCHNACKENBERG and PARKINSON, *Circuit Judges.*

PARKINSON, *Circuit Judge.* Crosstown Motors, Inc. (Crosstown) was adjudicated a bankrupt in August, 1957 on an involuntary petition following an assignment for the benefit of its creditors made on July 22, 1957. Prior thereto it was a Ford dealer in Chicago.

In October, 1955 Crosstown entered into a "floor plan" financing agreement with petitioner-appellant, Commercial Credit Corporation (Commercial). Commercial complied with all the requirements of the Illinois Trust Receipts Act and Commercial and Crosstown continued to operate under their financing agreement until July 20, 1957 when Commercial repossessed the automobiles which Crosstown then held under individual trust receipts running to Commercial.

For the period from January 1, 1957 to its assignment for the benefit of credits, Crosstown operated at a loss in excess of $32,000. On January 29, 1957 Commercial made a $25,000 unsecured capital loan to Crosstown to be repaid in twelve equal monthly payments of $2,083.34 each. Crosstown made the payments due in March, April,

May and June, and on July 16, 1957 paid the sum of $2,166.67, being the $2,083.34 payment due in July plus interest.

On July 12, 1957 Commercial made a "car check" at Crosstown and discovered Crosstown had sold eighteen cars out of trust without remitting to Commercial. On July 15, 1957 Commercial made demand on Crosstown pursuant to the provisions of §10 of the Illinois Trust Receipts Act.[1] Crosstown requested time to raise the money. On July 19, 1957 Commercial made another "car check" and learned that Crosstown had sold seven more cars out of trust without paying Commercial. Commercial made another demand. On that same day Crosstown executed a trust receipt to Commercial on ten unencumbered used trucks owned by Crosstown to cover a deficit incurred in the sale of 1956 Ford demonstrators in May, 1957, which trucks Commercial later sold for the sum of $5,250.

It is agreed by the parties to this appeal that all the proceeds from the out of trust sale of the twenty-five cars were used by Crosstown before July 19, 1957 to pay its payroll and other current obligations and none of such proceeds came into the bankrupt estate.

Commercial filed a petition for a prior lien on the general assets of the Bankrupt, claiming such a lien under §10 of the Illinois Trust Receipts Act in the sum of $50,578.24 for the twenty-five automobiles sold by Crosstown out of trust. Issues were joined by an answer alleging, *inter alia*, that §10, relied on by Commercial, does not create a lien on the general assets of the Bankrupt but is a state-created priority invalid under §64 of the Bankruptcy Act and that if said §10 does create a lien it would be invalid under §§60, 67 and 70 of the Bankruptcy Act; and by a counterclaim for the value of the ten used trucks trust receipted to Commercial by Crosstown on July 19, 1957 and for the payments made by Crosstown to Commercial on the $25,000 unsecured capital loan on

[1] Ill. Rev. Stat. 1957, Ch. 121½ §175.

March 19, April 16, May 17, June 18 and July 16, 1957 as voidable preferences and Commercial's reply thereto alleging, *inter alia*, that the transfer of the ten used trucks and the loan payments were not voidable preferences.

The cause was heard by the Referee in Bankruptcy. The Referee filed detailed findings of fact and conclusions of law and in conformance therewith entered an order denying Commercial's petition and ordering judgment on the counterclaim against Commercial in the sum of $7,416.67, representing the $5,250 for which Commercial sold the ten used trucks and the payment of July 16, 1957 of $2,166.67. On review the District Court affirmed the Referee, adopted the findings and conclusions of the Referee as its own and entered judgment conformably. This appeal followed.

To us the prime issue here is whether §10 of the Illinois Trust Receipt Act gives the entruster a lien on the general assets of a bankrupt or a priority in payment for the value of the proceeds from out of trust sales which were expended for operating expenses prior to bankruptcy.

This section entitled ENTRUSTER'S RIGHTS TO PROCEEDS reads, in applicable part, as follows:

> "Where, under the terms of the trust receipt transaction, the trustee * * *, having liberty of sale or other disposition, is to account to the entruster for the proceeds of any disposition of the goods * * *, the entruster shall be entitled, to the extent to which and as against all classes of persons as to whom his security interest was valid at the time of disposition by the trustee, as follows:
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> * * * * *
>
> "(b) To any proceeds or the value of any proceeds (whether such proceeds are identifiable or not) of the goods * * *, if said proceeds were received by the trustee within ten days prior to either application for appointment of a receiver of the trustee, or the filing of a petition in bankruptcy or judicial in

> solvency proceedings by or against the trustee, or demand made by the entruster for prompt accounting; and to a priority to the amount of such proceeds or value;".

Commercial cites and relies upon the case of *Inter-State Water Co.* v. *City of Danville*, 1942, 379 Ill. 41, as providing the rule of statutory construction which "is pertinent to the issues in this case." We agree. Thus we consider the entire Illinois Trust Receipts Act as a whole, with each part or section "construed in connection with every other part or section", and, as stated on page 46,

> "[i]n seeking the intent of the legislature the courts consider not only the language used but the evil to be remedied and the object to be attained."

The Uniform Trust Receipts Act was drafted long prior to 1938. It was adopted by the Illinois legislature in 1935. At that time §64 of the Bankruptcy Act specifically recognized state-created priorities. Thus the object to be attained by §10 of the Illinois Trust Receipts Act was to give to the entruster a priority ahead of general creditors upon insolvency of the trustee. Nothing more was necessary. Nothing more was contemplated. The legislative intent is crystal clear.

When the legislature provided in §10 that the entruster was entitled, on the insolvency of the trustee, "to a priority to the amount of" the proceeds from the goods or the value thereof it meant exactly what it said, *i.e.*, priority. A cursory examination of the entire Act clearly illustrates that when the legislature intended to mean lien the word "lien" was used. Thus, had it intended to create a lien on the general assets of the insolvent to the exclusion of the costs of administration as well as the general creditors, it certainly would not have used the word "priority". By so doing it specifically provided for only a preference or priority on distribution and thereby fixed the extent of the interest of the entruster in the insolvent's assets.

In 1938 Congress passed the Chandler Act whereby §64 of the Bankruptcy Act was amended, *inter alia*, by elimination of state-created priorities, with an exception as to rent which, of course, is not relevent here. The necessity for the exclusion of state-created priorities by Congress was obvious as many bankrupt estates had been consumed, to the exclusion of general creditors, by the ever-increasing classes of state priorities. Collier on Bankruptcy, Vol. 3, p. 2052.

When §10 of the Illinois Trust Receipts Act is silhouetted against this historical background the reason for the absence of the word "lien" and the use of the word "priority" is pellucid. In 1935, when the Illinois Trust Receipts Act was passed by the Illinois legislature, such a state-created priority was recognized in bankruptcy. However, since the passage of the Chandler Act the priority provided by §10 applied in insolvency proceedings other than bankruptcy but is void under §64 of the Bankruptcy Act now and as it existed at the time of the transactions in the case at bar. The cases of *Universal Credit Co.* v. *Citizens State Bank*, 224 Ind. 1; *Commercial Union Bank of Nashville* v. *Alexander, Tennessee*, 312 S.W.2d 611; and *Commercial Credit Corporation* v. *Bosse*, Idaho, 283 P. 2d 937; cited by Commercial are inapposite as they did not involve bankruptcy proceedings, and we disagree with the District Court in the case of *In re Harpeth Motors*, 135 F. Supp. 863, upon which Commercial relies so heavily.

Having decided that §10 of the Illinois Trust Receipts Act does not create a lien, the contention of Commercial that it had a contractual lien by virtue of the provision in each trust receipt that it was executed pursuant to the Uniform Trust Receipts Act as in effect in Illinois and that the entruster and trustee should have such other and further rights as may be provided by law is without merit. The short answer to this contention is that even if §10 of the Illinois Trust Receipts Act became a part of the trust receipt as though written out in full therein the trust receipt could not thereby create a lien where none existed under the statute.

The Referee found, which finding was adopted by the District Court, that on and after July 1, 1957 Crosstown was insolvent. Commercial contends that this finding is not sustained by sufficient evidence. The very most that can be said for Commercial's position is that the evidence on the question of insolvency was in conflict. We cannot say that this finding is clearly erroneous on this record, and we believe it to be adequately supported by the evidence.

On July 19, 1957 Crosstown had ten used trucks which were its free unencumbered property, for which it then gave Commercial a trust receipt. Commercial claims the consideration therefor was the release of the security interest in the 1956 Fords sold in May of 1957 at a loss of $17,500. Commercial argues that this is a valid consideration which removes the transfer from the category of a voidable preference as under the Illinois Trust Receipts Act the release or surrender of a valid security interest is within the purview of the definition of "new value". The argument is founded on a false premise. The Bankruptcy Act is here superior to any state statute. *Moore* v. *Bay*, 1931, 284 U.S. 4, 5; *In re V-I-D, Inc.*, 7 Cir., 1952, 198 F.2d 392, 396. It is undisputed that the trust receipt given by Crosstown to Commercial on July 19, 1957, covering the ten used trucks, was for a deficit incurred in the sale of some 1956 Ford demonstrators some two months previous. Therefore, the trust receipt constituted a transfer of property for an antecedent debt within the meaning of §60a of the Bankruptcy Act.

The Referee found that on and after July 1, 1957 Crosstown was insolvent and on July 12, 1957 Commercial had reason to so believe. Thus, the payment of $2,166.67 made to Commercial by Crosstown on July 16, 1957 and the transfer of the ten used trucks on July 19, 1957, later sold for $5,250, were preferences within the meaning of §60a of the Bankruptcy Act and void against the Trustee in Bankruptcy, and recovery on the counterclaim in the sum of $7,416.67 was justified.

Order and judgment affirmed.

APPENDIX B.

Judgment Below.

Thursday, October 15, 1959

Before

Hon. J. Earl Major, Circuit Judge

Hon. Elmer J. Schnackenberg, Circuit Judge

Hon. W. Lynn Parkinson, Circuit Judge

In the Matter of Crosstown Motors, Inc., Bankrupt.
COMMERCIAL CREDIT CORPORATION, a corporation,
Petitioner-Appellant,
No. 12610 vs.
C. WYLIE ALLEN, Trustee,
Respondent-Appellee.

Appeal from the United States District Court for the Northern District of Illinois, Eastern Division.

This cause came on to be heard on the transcript of the record from the United States District Court for the Northern District of Illinois, Eastern Division, and was argued by counsel.

On consideration whereof, it is ordered and adjudged by this court that the order and judgment of the said District Court entered therein on February 26, 1959, in this cause appealed from be, and the same is hereby, AFFIRMED, with costs, in accordance with the opinion of this Court filed this day.

APPENDIX C.

Order Denying Rehearing.

Tuesday, December 29, 1959

Before

Hon. Elmer J. Schnackenberg, Circuit Judge

Hon. J. Earl Major, Circuit Judge

It Is Ordered by the Court that the petition for rehearing filed by appellant in the above-entitled cause, be, and the same is hereby, DENIED.

APPENDIX D.

Sections 10, 19, and 22 of Illinois Uniform Trust Receipts Act, enacted 1935.

Section 10.

(Sec. 175—Chapter 121½—Illinois Revised Statutes (1957) State Bar Assn. Edition.

175. § 10. Entruster's rights to proceeds. Where under the terms of the trust receipt transaction, the trustee has no liberty of sale or other disposition, or, having liberty of sale or other disposition, is to account to the entruster for the proceeds of any disposition of the goods, documents or instruments, the entruster shall be entitled, to the extent to which and as against all classes of persons as to whom his security interest was valid at the time or disposition by the trustee, as follows:

(a) To the debts described in subsection three of section nine hereof;[1] and also

(b) To any proceeds or the value of any proceeds (whether such proceeds are identifiable or not) of the goods, documents or instruments, if said proceeds were received by the trustee within ten days prior to either application for appointment of a receiver of the trustee, or the filing of a petition in bankruptcy or judicial insolvency proceedings by or against the trustee, or demand made by the entruster for prompt accounting; and to a priority to the amount of such proceeds or value; and also

(c) To any other proceeds of the goods, documents or instruments which are identifiable.

[1] Section 174(3) of this chapter.

Section 19.

(Sec. 184—Chapter 121½—Illinois Revised Statutes (1957) State Bar Assn. Edition).

184. § 19. Uniformity of interpretation. This Act shall be so interpreted and construed as to effectuate its general purpose to make uniform the law of the states which enact it.

Section 22.

(Sec. 186—Chapter 121½—Illinois Revised Statutes (1957) State Bar Assn. Edition.

187. Title of act. § 22. This act may be cited as the Uniform Trust Receipts Act.

Section 60 a (1) of the Bankruptcy Act. (11 U.S.C. § 96)

"a.(1). A preference is a transfer, as defined in this Act, of any of the property of a debtor to or for the benefit of a creditor for or on account of an antecedent debt, made or suffered by such debtor while insolvent and within four months before the filing by or against him of the petition initiating a proceeding under this Act, the effect of which transfer will be to enable such creditor to obtain a greater percentage of his debt than some other creditor of the same class.

Section 67 c (2) of the Bankruptcy Act. (11 U.S.C. § 107)

"c. Where not enforced by sale before the filing of a petition initiating a proceeding under this Act, and except where the estate of the bankrupt is solvent: (1) though valid against the trustee under subdivision b of this section, statutory liens, including liens for taxes or debts owing to the United States or to any State or any subdivision thereof, on personal property not accompanied by possession of such property, and liens, whether statutory or not, of distress for rent shall be postponed in payment to the debts specified in

clauses (1) and (2) of subdivision a of section 64 of this Act and such liens for wages or for rent shall be restricted in the amount of their payment to the same extent as provided for wages and rent respectively in subdivision a of section 64 of this Act; and (2) the provisions of subdivision b of this section to the contrary notwithstanding, statutory liens created or recognized by the laws of any State for debts owing to any person, including any State or any subdivision thereof, on personal property not accompanied by possession of, or by levy upon or by sequestration or distraint of, such property, shall not be valid against the trustee: * * * * *

Section 70 e of the Bankruptcy Act. (11 U.S.C. § 110)

"e. (1) A transfer made or suffered or obligation incurred by a debtor adjudged a bankrupt under this Act which, under any Federal or State law applicable thereto, is fraudulent as against or voidable for any other reason by any creditor of the debtor, having a claim provable under this Act, shall be null and void as against the trustee of such debtor.

APPENDIX E.

In the Matter of Harpeth Motors, Inc., Bankrupt, 135 F. Supp. 863.

No. 22201.

WILLIAM A. MILLER, *District Judge.*

Universal C.I.T. Credit Corporation, hereinafter called Credit Corporation, filed its petition before the Referee for an order adjudging its asserted priority and security rights against the assets of the bankrupt under the provisions of certain trust receipts held by it and under the provisions of the Uniform Trust Receipts Law of Tennessee, Code Supp. 1950, § 7792.1 *et seq.*

Following a hearing, the Referee entered his order on September 21, 1954, disallowing and dismissing the petition. The case is presently before the Court upon the petition of the Credit Corporation for a review of the Referee's order and his findings of fact and conclusions of law.

It is the insistence of the Credit Corporation that it possessed a security interest in seven motor vehicles which had been placed in the hands of the bankrupt for sale under duly executed trust receipts, and that although the vehicles had been sold before bankruptcy and the proceeds therefrom cannot be identified or traced, it is nevertheless entitled to a prior secured claim against the bankrupt's assets. It seeks to support the contention under the provisions of Section 10 of the Tennessee Uniform Trust Receipts Law, 1950 Code Supplement, Section 7792.11. That section vests in the "entruster" in a trust receipt transaction (in this case the Credit Corporation), the right to the value of the proceeds of goods covered by a trust

receipt where the "trustee" in the transaction (in this case the bankrupt), has sold the goods and the proceeds therefrom cannot be traced or identified in the hands of the trustee.

The determinative question is whether Section 10 creates a lien upon the trustee's assets to secure payment of the entruster's claim for the value of unidentifiable proceeds, or whether it merely accords such value claim a priority in the distribution of the trustee's assets among his general creditors in insolvency or bankruptcy proceedings.

The Referee, having found that the proof was insufficient to trace the proceeds of the seven vehicles or to identify them in the hands of the bankrupt or in the hands of the trustee in bankruptcy, construed Section 10 of the Uniform Trust Receipts Law as vesting in the Credit Corporation as the entruster a right to the value of the proceeds protected merely by a priority in the distribution of assets among general creditors in insolvency, and not by a lien or charge in the nature of a lien against the assets of the trustee in the trust receipt transaction. He further held that such priority was not entitled to recognition in bankruptcy for the reason that Section 64 of the Bankruptcy Act, 11 U.S.C.A. § 104, accords priority only to certain classes of claims not including priorities created by state law.

It is undisputed from the evidence, and the Referee found, that the transactions between the Credit Corporation and the bankrupt with respect to the seven vehicles were "trust receipt transactions" within the meaning of the Uniform Trust Receipts Law of Tennessee; that the Credit Corporation as the entruster under the Act held duly executed trust receipts covering each of the motor vehicles; that the Credit Corporation, more than four months prior to the filing of the petition in bankruptcy, had duly filed with the Secretary of State of Tennessee, in conformity with the Act, a "Statement of Trust Receipt Financing" Code Supp.1950 Tenn. § 7792.14; that the seven vehicles were

sold by the bankrupt in the ordinary course of trade either for cash or partly for cash and partly for traded-in vehicles; and that the proceeds from the sales were received by the bankrupt although they could not be identified among its assets.

Section 10 of the Tennessee Uniform Trust Receipts Law, upon which the Credit Corporation relies, reads as follows:

> "Where, under the terms of the trust receipt transaction, the trustee has no liberty of sale or other disposition, or, having liberty of sale or other disposition, is to account to the entruster for the proceeds of any disposition of the goods, documents or instruments, the entruster shall be entitled, to the extent to which and as against all classes of persons as to whom his security interest was valid at the time of the disposition by the trustee, as follows: (a) to the debts described in section 7792.10(3); and also (b) to any proceeds or the value of any proceeds (whether such proceeds are identifiable or not) of the goods, documents or instruments, if said proceeds were received by the trustee within ten days prior to either application for appointment of a receiver of the trustee, or the filing of a petition in bankruptcy or judicial insolvency proceedings by or against the trustee, or demand made by the entruster for prompt accounting, and to a priority to the amount of such proceeds or value; and also (c) to any other proceeds of the goods, documents or instruments which are identifiable, unless the provision for accounting has been waived by the entruster by words or conduct; and knowledge by the entruster of the existence of proceeds, without demand for accounting made within ten days from such knowledge, shall be deemed such a waiver."

[1] If the statute merely confers a right of priority to the extent of the claim of value in the general distribution of the assets of the trustee in the security transaction, such right of priority, as the Referee correctly held, would

be unenforceable in the trustee's bankruptcy proceedings. This is true because the classes of claims given priority in distribution of assets in bankruptcy prescribed by Section 64 of the Bankruptcy Act are exclusive, and by the Chandler Amendment of 1938, state created priorities, with one exception not pertinent in this case, were eliminated from the Act. *Halpert* v. *Industrial Commissioner of the State of New York*, 2 Cir., 147 F.2d 375; *Strom* v. *Peikes*, 2 Cir., 123 F.2d 1003, 138 A.L.R. 937.

But Section 67, sub. b of the Bankruptcy Act preserves state created liens or security interests, although some legal proceedings or further steps may be necessary to effecuate them after bankruptcy has intervened. 4 Moore's Collier on Bankruptcy, 14th Ed., Section 67.20(2), p. 181.

A clear statement of the distinction between a lien and a right to priority of payment from unencumbered assets is set forth in 3 Moore's Collier on Bankruptcy, 14th Ed., Section 64.02, pp. 2055, 2056:

> "Considerable confusion exists in bankruptcy administration because of a failure to distinguish clearly between a valid lien and a right to prior payment from unincumbered assets. The former entails a right to enforcement independent of bankruptcy; it may be created by agreement or statute, or by judgment of a court. The latter is a narrow right to payment at a certain relative point in the distribution of a bankrupt debtor's property, naked of any power of levy or attachment; it is a creature of the Bankruptcy Act. Quite different consequences in bankruptcy are appended to each. A valid lien, subject to the qualifications and restrictions previously stated, is a charge against assets which must be met before distribution to unsecured creditors begins. A right to priority accords an unsecured claim a particular precedence over other claims in the distribution of the bankrupt's remaining assets. A particular debt may be secured by a lien arising from a statute or agreement, and yet be entitled to priority, too."

[2] The Uniform Trust Receipts Law has as its general purpose the regulation of transactions involving the use of trust receipts. Apparently the trust receipt was first used almost exclusively in the importing business, but for many years has been used in this country in connection with the financing by lending companies of the purchase of automobiles by automobile dealers. Annotation 168 A.L.R. 359, 360. The wide use of the trust receipt in this field of financing led to the formulation of the Uniform Act and its adoption by many of the states. Its underlying policy and general purpose are summarized in the Annotation in 168 A.L.R., (p. 360), as follows:

> "The Trust Receipts Act is evidently the result of an effort to meet the needs of the business of financing the purchase and sale of goods on credit without the use of chattel mortgages, and without recording each lien transaction. The apparent purpose in permitting the filing of a statement by such financer and dealer is to have some method of giving notice to other prospective creditors that the former are doing business by the trust-receipt financing method. The purpose seems to have been to retain the advantages of a security interest in goods by use of the trust receipt and yet to eliminate, as far as possible, both secret liens and the necessity of recording each transaction. *Donn* v. *Auto Dealers Invest. Co.*, 1944, 385 Ill. 211, 52 N.E.2d 695. See also *Commercial Discount Co.* v. *LosAngeles County*, 1940, 16 Cal.2d 158, 105 P.2d 115, *infra*, V b.
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> "The principal purpose of the Uniform Trust Receipts Act was to facilitate the financing of sales and other transactions and to afford the 'lender every conceivable protection in handling trust receipt and pledge transactions, so that the use of these security devices may be increased.' *Commercial Credit Corp.* v. *Horan*, 1945, 325 Ill.App. 625, 60 N.E.2d 763."

The Tennessee Act, 1950 Code Supplement, Sections 7792.1—7792.19, defines the term "security interest" as follows:

"'Security interest' means a property interest in goods, documents, or instruments, limited in extent to securing performance of some obligation of the trustee or of some third person to the entruster, and includes the interest of a pledgee, and title, whether or not expressed to be absolute, whenever such title is in substance taken or retained for security only."

By Section 13, 1950 Code Supplement Section 7792.14, provision is made for recording by conferring upon the entruster the right to file with the Secretary of State a statement of trust receipt financing setting forth that the entruster and the trustee propose to engage in financing under trust receipt transactions.

After such filing with the Secretary of State, the security interest of the entruster under individual trust receipts is protected against general creditors and subsequent lien creditors, as well as against subsequent purchasers other than purchasers in the ordinary course of trade. 1950 Code Supplement, Sections 7792.8, 7792.9, 7792.10.

[3] That the statute creates a security interest clearly appears from the definition of the term "entruster" as meaning a person 'who has or directly or by agent takes a security interest in goods, documents or instruments under a trust receipt transaction, and any successor in interest of such person." 1950 Code Supplement, Section 7792.2.

The term "trustee" is defined as "the person having or taking possession of goods, documents or instruments under a trust receipt transaction, and any successor in interest of such person." However, the Act provides that the use of the word trustee "shall not be interpreted or construed to imply the existence of a trust or any right or duty of a trustee in the sense of equity jurisprudence other than as provided by this chapter." Code Supp.1950 Tenn. § 7792.2. To enforce the security interest of the entruster the Act confers upon him broad rights to repossess the property and to sell it at public or private

sale, the proceeds of sale to be applied to discharge the debt secured and the remainder to be paid over to the trustee.

[4] Section 10 of the Act extends the security interest or lien of the entruster, under certain conditions, to the proceeds derived from the sale of the entrusted goods where such proceeds can be identified or traced. That result was reached by the Supreme Court of Indiana in *Universal Credit Corporation, Inc.*, v. *Citizens State Bank*, 224 Ind. 1, 64 N.E. 2d 28, 168 A.L.R. 352, in construing a section of the Uniform Trust Receipts Act of that state which is the counterpart of Section 10 of the Tennessee Act. There was a similar holding in *Hamilton National Bank* v. *McCallum*, 6 Cir. 58 F.2d 912, with respect to identifiable proceeds of entrusted property, although the case was decided under the terms of common law trust receipts not regulated or controlled by statute. The specific holding was that the lien of the entruster extended to identifiable proceeds and was enforceable in the bankruptcy proceedings of the trustee in the trust receipt transaction under Section 67 of the Bankruptcy Act.

But no case has been found and none has been cited by counsel dealing with the question either at common law or under statute whether the entruster's security interest extends to the assets of the trustee in the trust receipt transaction where the proceeds from the sale of the entrusted property cannot be traced or identified.

[5] Although the interpretation of the statute is not free from doubt, the Court is of the opinion that it was the legislative purpose under Section 10 not only to create a lien upon identifiable proceeds derived from the sale of entrusted goods, but also to create a lien upon the trustee's other assets to secure payment of the value of the proceeds in the event the proceeds cannot be identified or traced. Admittedly, such a lien to secure the value of the proceeds is not conferred by the statute in express terms, but the failure to create the lien expressly is not

fatal to its existence if it follows by necessary implication from the terms of the statute.

If Section 10 went no further than to confer upon the entruster the right to receive the value of unidentifiable proceeds and accorded to such right a priority in distribution of the trustee's assets among general creditors, it would clearly be a mere state created priority not enforceable in the bankruptcy proceeding o fthe trustee. But it appears to the Court that Section 10 can be given such a limited scope only by disregarding certain language of the section, particularly the clause "to the extent to which and as against all classes of persons as to whom his security interest was valid at the time of disposition by the trustee".

This language, which qualifies all rights conferred by Section 10, places the entruster's right to receive the "value" of unidentifiable proceeds upon the same plane and in effect gives it the same scope and status as the entruster's security interest in the entrusted goods before their sale by the trustee. It is apparent that the phrases "to the extent to which" and "all classes of persons" refer to the other provisions of the Act defining the classes of persons as to whom the entruster's security interest is valid and enforceable, as well as those provisions defining the scope of the security interest. As observed above, where filing has been made with the Secretary of State, the classes of persons as to whom the entruster's security interest is valid, include (a) general creditors of the trustee, (b) subsequent purchasers other than purchasers in the ordinary course of trade, and (c) subsequent lien creditors whether their liens are acquired by attachment, levy, or by any other similar operation of law or judicial process.

[6] The term "lien" is generally defined as a charge upon property for the payment or discharge of a debt or duty, or a right which the law gives to have a debt satisfied out of a particular thing. 33 Am.Jur. Liens, Sec. 2, p. 419. The right to receive the "value" derived from the sale or disposition of entrusted goods neces-

sarily contemplates payment of such value out of the general assets of the trustee. It thus constitutes a charge against the trustee's property and being, by the express terms of the statute, valid and enforceable against and having priority over both general and subsequent lien creditors as well as subsequent purchasers other than purchasers in the ordinary course of trade, it is practically and legally indistinguishable from a technical lien. Since it is a claim which is enforceable to the same extent and as against the same persons as the entruster's security interest in the entrusted goods, it would appear that a lien is impressed to the extent of the value of the proceeds as effectively as if it had been declared by the statute in express terms. No reason appears why such a superior charge against the trustee's assets could not be enforced, as any other lien, by proceedings in a court of equity by attachment or injunction or other similar process.

[7] Viewed in this light, it is apparent that the statute with respect to the value right or claim of the entruster goes much further than to create a mere priority in the distribution of the assets of the trustee in insolvency proceedings, for it creates in the entruster's favor a claim against the trustee's property having the same status as a lien claim and enforceable as such independently of an insolvency or bankruptcy proceeding.

The construction of the Uniform Act as conferring a mere priority upon a general distribution of the trustee's assets, without a security interest, appears to be incompatible with both the wording and general purpose of Section 10. The language employed, as already noted, leaves no doubt that it was the purpose of the Section to place the claim of the entruster to the proceeds or their value upon the same legal basis as his security interest in the goods covered by the trust receipt. A different interpretation would altogether fail to account for the express provision that the rights conferred by Section 10 shall be valid and enforceable to the same extent and as against the same classes of persons as the security interest in the goods.

[8] Moreover, Section 10 cannot reasonably be construed as making the insolvency of the trustee a condition precedent to the rights conferred. On the contrary, the language of the section is that the rights created may be preserved *either* by making a timely demand for an accounting within ten days from the receipt of proceeds, *or* by the intervention within that period of bankruptcy, receivership, or insolvency proceedings. The requirement for a ten-day demand would thus appear to have been intended to preserve the entruster's rights even in the absence of a proceeding looking to the general distribution of the assets of the trustee. The strict time limitation imposed to preserve the rights conferred, in the absence of insolvency proceedings, corroborates the idea that a security interest was intended, as there would appear to be no particular reason for such a requirement to enforce a bare priority right.

In the absence of a general insolvency proceeding occurring within the ten-day period, it is incumbent upon the entruster, in order to preserve his rights, to maintain a constant surveillance over the trustee's sales and to make the demand for an accounting within the ten-day period. If the demand is not made as required by subsection b of Section 10, the right of the entruster to receive the value of proceeds which cannot be identified is extinguished. However, under subsection c the entruster would still have the right to receive any proceeds which he was able to identify, provided that he makes a demand for an accounting within ten days after he acquires actual knowledge that such proceeds exist.

Under the view which the Court takes of the Uniform Act it is not necessary to discuss the general principles governing the tracing of trust funds in the hands of a bankrupt at the time bankruptcy intervenes. These principles were referred to by the Referee in his findings, but the notion that the Uniform Trust Receipts Act provides for a trust is inconsistent with the express provisions of the Act that the creation of a trust is not intended, as well as the general scheme of the Act to

provide merely for a security interest. The trust theory would also involve the difficulty that Section 10 expressly provides that the rights of the entruster are preserved whether the proceeds are identifiable or not, thus excusing the usual requirements for tracing trust funds.

The Referee also indicated in his findings that he construed the petition of the Credit Corporation as not claiming a lien but merely priority rights in the distribution of assets. However, it apppears to the Court that the petition, fairly construed, is broad enough to claim all rights to which the Credit Corporation is entitled under the Uniform Trust Receipts Act, including any lien or security rights, particularly in view of the prayer of the petition for general relief.

As the rights of the Credit Corporation are governed by subsection b of Section 10 of the Uniform Act, the question remains whether it made demand for a prompt accounting with respect to the seven vehicles within ten days after the bankrupt received the proceeds from their sale, there being no question that bankruptcy did not intervene until after expiration of the ten-day period.

From an examination of the evidence, it is found that there is no dispute as to the dates when demands were made by the Credit Corporation for accountings, although there is some conflict as to the dates when the vehicles were sold and the proceeds of sale received by the bankrupt. However, as to receipt of proceeds the Court agrees with the Referee that the testimony of the Secretary of the bankrupt should be accepted since she testified from her records and not from memory.

It is disclosed that the Credit Corporation made demand for an accounting on April 11, 1949. This demand was timely as to three of the vehicles, the Ford Tudor bearing No. 547545, and the Ford Fordor bearing No. 549557, both sold on April 6, 1949, and the Ford Custom Tudor bearing No. 547580 sold on April 11, 1949. The

demand of April 11, 1949 was not timely as to the two Ford Business Coupes, bearing Nos. 527018 and 529236 sold on March 28, 1949. Another demand was made on April 18, 1949 with respect to a Ford Truck bearing No. 141028 and a Ford Convertible bearing No. 503904. But the Ford Truck was sold September 30, 1948, although the proceeds had been received September 16, 1948, and the Ford Convertible was sold on March 31, 1949.

It results that the security claim of the Credit Corporation is sustained as to the first three vehicles mentioned above and is disallowed as to the remaining vehicles.

A judgment will be submitted accordingly.

APPENDIX F.

69 Harvard Law Review p. 1343 (1956).

"The effect of the trustee's bankruptcy upon the entruster's rights depends on whether the Uniform Trust Receipts Act gives the entruster a *security interest* in the debtor's property or only a priority. A *security interest* is a right, arising from contract or statute, to enforce claims against a debtor's property, and may be asserted in an insolvency proceeding or by other means; a *priority* is simply a right to receive payment from an insolvent estate before other claimants and embodies no power of levy or attachment. 3 Collier, Bankruptcy § 6402, at page 2055 (14th ed. 1941). The Bankruptcy Act recognizes state-created security interests, see *id.* § 67.20(1), at 181 (1942), but not state created priorities, except those in favor of landlords, 52 Stat. 874 (1938), as amended. 11 U.S.C. § 104 (1952); see *Strom* v. *Peikes*, 123 F. 2nd 1002 (2d Cir. 1941). Although it is generally agreed that state law determines whether a creditor has a *security interest*, some courts have relied exclusively on the label which state law gives the interest, and have ignored its legal incidents. See *In re West Beverly Corp.*, 166 F. 2d 429 (9th Cir. 1948). This enables a state to disrupt the federal heirarchy of priorities by labeling all favored claims 'liens'. See 51 Yale L.J. 863, 866 n. 27 (1942). But, see *Local Loan Co.* v. *Hunt*, 292 U.S. 234 (1934). This result can be avoided if it is held that state law creates a *security interest* only if it gives the creditor rights in the debtor's property which are enforceable outside of insolvency proceedings. The Court in the instant case seems to have taken this approach in construing the Uniform Trust Receipts Act. Section 18 states that the Act is to be construed uniformly with decisions construing it in other states adopting the Act. Such decisions hold that the entruster has an interest in identifiable proceeds enforceable outside of insolvency proceedings. See

e.g. Universal Credit Corp. v. *Citizens State Bank,* 224 Ind. 1, 64 N.E. 2d 28 (1945). It has been held that this lien is valid in bankruptcy. *Taylor* v. *Quittner,* 218 F. 2d 549 (9th Cir. 1945). Since the wording of Section 10(b) of the Trust Receipts Act evidences an intent to give entruster similar rights where proceeds are unidentifiable, the present court seems correct in holding that the finance company had a general lien on the assets of the debtor. Despite the use of the term 'priority'; the section clearly seems to have been designed to prevent the entruster from being deprived of a *security interest* by the sale of the entrusted goods, the transaction which the trust receipts arrangement is intended to facilitate. The Uniform Commercial Code removes the terminological difficulty by providing that the entruster after sale of the goods shall have a 'security interest' in certain defined assets of the trustee. Uniform Commercial Codes, Sec. 9-306. However, a suggested amendment to the Code would revise the problem by reintroducing the word 'priority'. Uniform Commercial Code Sec. 9-306 (Supp. 1, 1955).

"Although an entruster might have a valid general lien under state law, the lien might be invalidated in bankruptcy by Sec. 67c(2), 66 Stat. 428, 11 U.S.C. Sec. 107(c)(2) (1952), adopted subsequent to the creation of the security interest involved in the instant case, which invalidates statutory liens not accompanied by possession, levy, sequestration, or distraint. It has been suggested that security interests defined and regulated by statute may be 'statutory liens' within the meaning of Section 67. See Hanna, *Preferences as Affected* by Section 60c and Section 67b of the Bankruptcy Law, 25 Wash. L. Rev. 1.14 (1950). However, it seems more probable that the section was not intended to include security arrangements which are basically consensual, even though they are regulated by statute. See 4 Collier, Bankruptcy, Sec. 67.25 (14th ed. 1942). Indeed a recent case has held that a factor's lien obtained pursuant to statute is not a 'statutory lien' within the meaning of Sec. 67c(1), 30 Stat. 564 (1898), as amended, 11 U.S.C. Sec. 107(a)(1) (1952). *In the matter of Tele-Tone Radio Corp.,* 133 F. Supp. 739* (D.C. N.J. 1955), 69 Harv. L. Rev. 756 (1956)."

*** See In the matter of The New Haven Clock & Watch Co. (C.C.A. 2nd Cir. 1958, 253 F. (2nd) 577.**

APPENDIX G.

66 Yale Law Journal 922.

NOTES

THE ENTRUSTER'S RIGHT TO PROCEEDS OF SALE UNDER SECTION 10 OF THE UNIFORM TRUST RECEIPTS ACT

The Uniform Trust Receipts Act (UTRA)[1] provides a chattel security device designed to facilitate credit transactions between financers, manufacturers, and dealers of consumer durables.[2] In the typical transaction the

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[1] Reprinted in 9A Uniform Laws Ann. 284-317 (hereinafter cited as U.L.A.). The Uniform Trust Receipts Act (hereinafter cited as UTRA) was approved by the National Conference of Commissioners on Uniform State Laws in 1933, id. at 274, and has been adopted by thirty-two states and remains the law of thirty-one. Pennsylvnia adopted the Uniform Commercial Code repealing the UTRA, Pa. Stat. Ann. tit. 12A (Purdon 1954).

[2] The trust receipt was originally devised by commercial banks for use in financing of import shipments and received common law recognition as early as 1843. For the early history of trust receipts see Frederick, **The Trust Receipt as Security**, 22 Colum. L. Rev. 395, 546 (1922). When the UTRA was drafted in 1933 the common law trust receipt was being employed extensively to finance domestic shipments of automobiles and other consumer durables. At this same period of development, however, courts treated this device differently from state to state and the utility of the trust receipt was being curtailed by rather sterile legal technicalities. Some courts thought that in its "true nature" the trust receipt was just another form of pledge, chattel mortgage or conditional sale, and consequently that a trust receipt could create a valid security interest only by conforming to the legal requirements of the device with which it was identified. Other courts apparently recognized what they called "tripartite" arrangements in which the dealer

bank or finance company (entruster) pays the manufacturer for goods sold and delivered to the dealer (trustee),[3] receiving in return a security interest in the goods under a trust receipt executed by the dealer.[4] The trust receipt arrangement permits the dealer to sell the goods in the ordinary course of trade free of the entruster's security

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acquired the goods or documents to title from the entruster, but invalidated "bipartite" arrangements permitting acquisition directly from the manufacturer. The UTRA was drafted to obviate this legal formalism, to promote uniformity, and to preserve the trust receipt for its growing commercial utilization. Commissioners' Prefatory Note, **Why the Uniform Trust Receipts Act was Drafted**, 9A U.L.A. 274-77; Gilmore, **Chattel Security: II**, 57 Yale L.J. 761-65 (1948); notes 3, 4, 11 **infra** and accompanying text.

[3] The manufacturer generally forwards bills of lading covering shipments directly to the entruster who gives copies to the dealer in exchange for trust receipts. But when bills of lading are forwarded first to the dealer, this departure from what was considered a "tripartite" arrangement does not invalidate the transaction. UTRA § 2-1 (b); Universal Credit Co. v. Citizens State Bank, 224 Ind. 1, 64, N.E. 2d 28 (1945). For detailed discussion of the trust receipt transaction see Gilmore & Black, Admiralty §§ 3-21 (to be published, Foundation Press, 1957).

[4] If a statement of trust receipt financing has been properly filed, the entruster's security interest in the goods is superior to that of all the dealer's purchasers, creditors and lienors, UTRA § 7, except buyers in the ordinary course of trade, **id.** § 9-2(a); purchasers of negotiable instruments or documents and of "as if" negotiable instruments, **id.** § 9-1 (a); and encumbrances whose liens arise in connection with the processing, warehousing, shipping, etc., of the goods, **id.** § 11.

A simple statement of trust receipt financing, filed with the Secretary of State by the entruster, designating the dealer and containing a general description of the goods, fulfills all recordation requirements for one year. **Id.** § 13. Since this provision affords an inexpensive (usually one dollar) and convenient filing procedure, failure to file has not become a commercially significant problem in the field of dealer financing. Gilmore, **The Commercial Doctrine of Good Faith Purchase**, 63 Yale L.J. 1057, 1103 (1954). **But see Note**, 66 Yale L.J. 567 (1957) (discussing choice of proper place to file multistate transaction under UTRA).

interest,[5] but requires the dealer to repay his debt to the entruster immediately upon sale.[6] As long as the dealer liquidates his trust receipt debts in this manner he is permitted to execute new trust receipts to finance replacement inventory, thus receiving a continuing line of credit.[7] When the dealer defaults by retaining the proceeds of sale, the UTRA undertakes to protect the entruster; section 10 provides that his security interest shifts to these proceeds[8] and survives for ten days.[9] The UTRA thus seeks to give both dealer and financer the advantages of floating liens, but it avoids the two features which have traditionally led courts to hold floating

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[5] UTRA §9-2(a).

[6] Section 10, which shifts the entruster's security interest to the proceeds, is operative only if the dealer has no liberty of sale, or having liberty of sale is to account for proceeds. The entruster derives no benefit from withholding liberty of sale since under § 9-2(a) (ii) a buyer in the ordinary course of trade takes free of the entruster's interest despite such a limitation. In fact if the entruster does not give power of sale, and thus imposes no duty to account, the security arrangement is more likely to be invalidated under the doctrine of Benedict v. Ratner, 268 U.S. 353 (1925). It is probably for these reasons that the terms of the trust receipt agreement always impose on the dealer a duty to account to the entruster for proceeds immediately upon sale. See Heindl, **Trust Receipt Financing Under the Uniform Trust Receipts Act**, 26 Chi.-Kent L. Rev. 197, 257 (1948).

[7] In nearly all trust arrangements the entruster sends a letter of credit in favor of the dealer to the manufacturer. This instrument generally states the volume of goods which the dealer may order during a specific period and contains the entruster's promise to pay the manufacturer for these goods by accepting all drafts which are accompanied by proper shipping documents. The entruster, however, retains the right to revoke the letter of credit, and presumably will revoke, if the dealer fails to maintain an expected rate of repayment. See Gilmore, **Chattel Security: II**, 57 Yale L.J. 761-62, 768 (1948); McGowan, Trust Receipts 14-15 (1947).

[8] See pages 928-31 **infra**.

[9] See note 58 **infra** and accompanying text.

liens illegal.[10] In the first instance, the dealer's power of sale is distinguished from that associated with floating lien arrangements primarily by the requirement that his debt be immediately liquidated.[11] Secondly, the UTRA gives the entruster the equivalent of a continuous security interest in a moving stock of goods, but in contrast to a floating lien, the entruster's ten day lien shifts not to after-acquired inventory, but to the proceeds of sale.

Despite these dissimiliarities from the typical floating lien, the entruster's claim to a lien on proceeds under section 10 may encounter serious difficulty. The proceeds of dealer sales are usually conditional sales contracts. Since the dealer often discounts these contracts with the entruster, the former's loan is paid and no lien problems arise.[12] In some instances, however, the dealer assigns the contracts for value to a second bank or finance company. In these cases, the entruster will seek to preserve his security interest by asserting a lien under section 10 either

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[10] In most states liens are said to "float," and are held illegal as a fraud on creditors, when the borrower is given power to sell collateral with no correlative duty to account immediately to the lienor for the proceeds, and the security agreement provides that the lien shifts to after-acquired inventory. Cohen & Gerber, **Mortgages of Merchandise**, 39 Colum. L. Rev. 1338 (1939) (discussing different state definitions of floating liens and collecting cases); Cohen & Gerber, **The After-Acquired Property Clause**, 87 U. Pa. L. Rev. 635, 656-59 (1939) (same); Gilmore & Axelrod, **Chattel Security: I**, 57 Yale L.J. 517, 534-35 (1948).

[11] See note 6 **supra**, and authorities cited note 10 **supra**.

[12] The principal reason that banks and finance companies enter into trust receipt arrangements is to obtain conditional sales contracts from dealers. Trust receipt financing is carried out at comparatively low rates with little profit to the financer, while the financing of consumer sales under conditional sales contracts is a highly profitable enterprise. Thus, in most instances, dealer financing will be discontinued when a dealer fails to assign substantially all of this consumer paper to his entruster. Gilmore, **The Commercial Doctrine of Good Faith Purchase**, 63 Yale L.J. 1057, 1102 (1954).

on the conditional sales contracts or on the proceeds received by the dealer from discounting the chattel paper. The second type of lien presents difficult bankruptcy problems. Since the proceeds retained by the dealer will generally be commingled with his other assets, they can seldom be traced and identified. Because of the unclear language of section 10 and the paucity of judicial interpretation, it is as yet uncertain whether this section authorizes a lien on unidentifiable proceeds and whether such a lien is enforceable in bankruptcy.[13] The entruster would therefore prefer to establish a lien on the conditional sales contracts. In this context, he would not be involved in bankruptcy proceedings since he claims only against the assignee; outside of bankruptcy, a lien of such identifiable proceeds has always been held vaild.[14] Furthermore, sustaining his claim, the entruster would receive the interest payments on the conditional sales contracts. The claim would be challenged, however, by the assignee of the conditional sales contract, asserting his rights as a bona fide purchaser under section 9.[15] In sum, the practical value of the entruster's security interest depends on two unsettled issues: whether the assignee can prevail over the entruster claiming under section 10 and thereby retain the conditional sales contracts; and, if so, whether the entruster can still retrieve this loss by claiming a section 10 lien on the unidentifiable proceeds of the sale.

To defeat the entruster's claim to the conditional sales contracts, the assignee argues that he fits within section 9-1(a), which provides that a good faith purchaser for value of instruments which "are by common practice purchased and sold as if negotiable" hold such in-

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[13] In the only case in which this problem was presented, the court held that § 10 did establish a valid consensual lien on unidentifiable proceeds. In the Matter of Harpeth Motors, Inc., 135 F. Supp. 863 (M.D. Tenn. 1955).

[14] Universal Credit Co. v. Citizens State Bank, 224 Ind. I, 64 N.E.2d 28 (1945) See cases cited note 16 infra.

[15] See notes 16 and 17 infra.

struments free of the entruster's interest if he took them "by transfer in the customary manner." The few cases which have considered the assignee's section 9 argument have disagreed as to its merits. Some courts have upheld the entruster's claim, reasoning that section 9-1(a) is not applicable to conditional sales contracts.[16] But several cases have allowed the assignee of the chattel paper to avoid the entruster's claim.[17] The section can easily be construed to compel the latter result. Since section 9-1 (a)'s phrase "purchased and sold as if negotiable" is not specifically defined by the statute, its meaning may be inferred from usage; section 9-1(a)'s insistance on a transfer "in the customary manner" may suggest that an instrument which is transferred in the manner in which negotiable instruments are transferred is one which is "purchased and sold as if negotiable." If, as seems likely, the "customary manner" of transfer is by indorsement and delivery, conditional sales contracts, which are customarily so transferred, are "purchased and sold as if

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[16] Canandaigua Nat'l Bank and Trust Co. v. Commercial Credit Corp., 285 App. Div. 7, 135 N.Y.S.2d 66 (4th Dep't 1954); General Motors Acceptance Corp. v. Associates Discount Corp., 38 N.Y.S.2d 972 (Mun. Ct. 1942), **rev'd on other grounds**, 267 App. Div. 1032, 48 N.Y.S.2d 242 (4th Dep't 1944); B.S.C. Corp. v. Colonial Discount Co., 169 Misc. 711, 8 N.Y.S.2d 65 (City Ct. 1938).

[17] Citizens Nat'l Trust and Sav. Bank v. Beverly Finance Co., 127 Cal. App. 2d 835, 273 P.2d 714 (1954); Bank of America Nat'l Trust & Sav. Ass'n v. National Funding Corp., 45 Cal. App. 2d 320, 114 P.2d 49 (1941); Farmers Nat'l Bank v. Universal Credit Co., 259 App. Div. 955, 20 N.Y.S. 2d 1004 (3rd Dep't 1940). See also North American Acceptance Corp. v. Northern Ill. Corp., 347 Ill. App. 89, 106 N.E. 2d 197 (1952) (§ 9-1 (a) held applicable by implication but entruster prevailed since assignee was not good faith purchaser for value).

The assignee's alternative argument that he was a buyer in the ordinary course of trade under § 9-2(a) was indorsed in Bank of America Nat'l Trust & Sav. Ass'n v. National Funding Corp., **supra**, but rejected in B.S.C. Corp. v. Colonial Discount Co., **supra** note 16.

negotiable." The good faith assignee for value then is entitled to retain these "as if negotiable" contracts if he took them by indorsement and delivery.[18]

Commercial policy favors a construction that would place conditional sales contracts within the "as if negotiable" category of section 9-1(a). A considerable body of statutory and case law denies full negotiability to con-

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[18] Gilmore, **The Commercial Doctrine of Good Faith Purchase**, 63 Yale L.J. 1057, 1103-04 (1954).

Section 9-1(a) applies only to "instruments". Section 1 defines "instrument as a "credit . . . instrument of a sort marketed in the ordinary course of business or finance, of which the trustee after the trust receipt transaction, appears by virtue of possession and the face of the instrument to be the owner." Arguably, conditional sales contracts are within this definition. **Id.** at 1104. Alternatively, it may be argued that § 9-1(a) usage, "instruments . . . sold as if negotiable" is not meant to be tested by the instrument definition of § 1.

In either event the strong similarity between the basic characteristics of negotiable instruments and conditional sales contracts further suggests that the latter are in fact "purchased and sold as if negotiable". The presumptions of Negotiable Instruments Law §§ 24, 16, 14, 59, implementing a policy of free negotiability, encourage the transferee to accept an instrument "complete and regular on its face" as evidence of a valid debt substantially free from latent defects. The assignee of a conditional sales contract similarly relies on its regularity. Neither the transferee of a negotiable instrument nor the assignee of a conditional sales contract takes from all defenses. The assignee may be subject to consumer's defenses such as breach of warranty; the transferee is subject to such real defenses as fraud on the drawer or maker. For so-called "real defenses" to negotiable instruments, see **id.** § 55. In each case the transferee or assignee relies on the regularity of his instrument; real defects are considered as risks of the enterprise rather than as risks of the particular transaction.

An additional argument may be premised on the fact that under the law of most states promissory notes do not lose their negotiable character when attached to conditional sales contracts. Gilmore, **supra** at 1097 & n.119. Section 9-1(a) clearly applies to negotiable instruments. Consequently, even

ditional sales contracts.[19] But the purpose of denying full negotiability is to enable the consumer to assert against the assignee-financer those defenses which would be good against the dealer. This purpose should not be persuasive in the totally different context of two institutional lenders asserting competing equities of ownership.[20] In fact it would be more to the consumer's advantage for the assignee to take free of the entruster's lien. Allowing the entruster to maintain his security interest in this paper after assignment would tend to decrease competition among consumer credit financers, and consequently to exert an unfavorable influence on interest rates charged consumers.[21] On the other hand, the interpreta-

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if it is held not to apply to conditional sales contracts, the assigneee who loses his claim to the entruster could conceivably still retain the negotiable notes. Since the common law rule is that the security follows the note, **id.** at 1081-82 & n.83, a construction of § 9-1(a) which deemed it inapplicable to conditional sales contracts would be of little value to the entruster and would promote duplication of law suits.

[19] Conditional sales contracts do not meet the requisites of negotiability as set out in Negotiable Instruments Law §§ 1-10. See, **e.g.**, Gale & Co. v. Wallace, 210 Ark. 161, 163, 194 S.W.2d 881, 882 (1946); General Motors Acceptance Corp. v. Davis, 169 Kan. 220, 218 P.2d 181 (1950).

[20] Gilmore, **The Commercial Doctrine of Good Faith Purchase,** 63 Yale L.J. 1057, 1101 (1954).

[21] Prohibitive financing rates charged consumers on installment loans under conditional sales contracts have long been a serious problem. Note, 60 Yale L.J. 1218 (1951); Gilmore, **The Commercial Doctrine of Good Faith Purchase,** 63 Yale L.J. 1057 (1954). A partial solution has been effected in some states under statutes protecting the consumer's right to choose between financers and requiring dealers adequately to inform consumers as to all elements of the financing arrangement. See, **e.g.**, N.Y. Pers. Prop. Law §§ 301-11. See Gilmore, **The Secured Transactions Article of the Commercial Code,** 16 Law & Contemp. Prob. 27, 37 (1951); Donaldson, **An Analysis of Retail Installment Sales Legislation,** 19 Rocky

tion of section 9-1(a) suggested above would enhance the mobility of chattel paper, thus serving the interest of the consumer credit industry which is substantially dependent on such ready assignability.[22]

Protecting the assignee's interest does introduce the possibility of abuse. Most cases litigated dealing with the relative rights of the entruster and assignee of a conditional sales contract arise when the dealer corporation has purported to sell a trust receipted automobile on credit to its president, a relative or an employee.[23] This enables the dealer who assigns the fictitious vendee's conditional sales contract to a second finance company to obtain two loans on the same security, which never leaves the premises. Under the UTRA the entruster must normally bear the risk of a dealer's dishonesty since he is deemed to be in the best position to scrutinize the dealer's activities.[24] But even with frequent and careful investigation it is impossible for the entruster to prevent such fictitious sales. On the other hand ,the assignee, whose normal inquiry about the automobile consumer will often disclose whether he has any connection with the dealer corporation, is in a relatively good position to prevent this type of double financing.[25]

The good faith proviso of section 9 is, however, a sufficient safeguard against abuse. Section 9 protects the second financer's claim to the conditional sales contract only when he can successfully meet the burden of

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Mt. L. Rev. 135 (1946). This desirable trend could be derogated, however, by allowing entrusters to monopolize dealer consumer paper. Uniform Commercial Code § 9-306, comment 2(c); id. § 9-308 (1956 Recommendations of the Editorial Board); Note, 61 Yale L.J. 718, 727 (1952).

[22] Gilmore, **The Commercial Doctrine of Good Faith Purchase**, 63 Yale L.J. 1057, 1093-1102 (1954).

[23] The seven cases reported in notes 16 and 17 **supra** are all cases of fictitious sales.

[24] Commissioner's Prefatory Note, 9A U.L.A. 278.

[25] See Seidman, Finance Companies and Factors 129 (1949).

persuasion as to his own good faith.[26] Actual notice of the entruster's lien on the specific item sold prevents the assignee from proving good faith.[27] However, the assignee seldom has such notice; in practice, he may only know that the dealer generally engages in trust receipt financing. In a bona fide sale, this kind of notice should be irrelevant and the assignee should be held in good faith.[28] Since the chattel leaves the dealer's premises after a bona fide sale, the assignee may expect that the entruster in policing the dealer's inventory will learn that the chattel is missing, will demand an accounting and be paid from the amount given by the assignee to the dealer for the conditional sales contract. But if the assignee knows that the sale is fictitious and has notice that the dealer is usually financed through trust receipts, his participation in the scheme demonstrates his own dishonesty. If he should have reason initially to suspect a close relationship

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[26] See page 924 **supra.** North Am. Acceptance Corp., v. Northern Ill. Corp., 347 Ill. App. 89, 106 N.E.2d 197 (1952).

[27] Gilmore, **The Commercial Doctrine of Good Faith Purchase,** 63 Yale L.J. 1057, 1105 (1954) (reasoning from § 9-1 (a) which provides that "filing under this act shall not be deemed to constitute notice of the entruster's interest to purchasers in good faith . . .," that a purchaser with actual notice of the entruster's security interest cannot retain the conditional sales contract); General Motors Acceptance Corp. v. Associates Discount Corp., 38 N.Y.S.2d 972, 978-79 (Mun. Ct. 1942) (dictum; same), **rev'd,** 267 App. Div. 1032, 48 N.Y.S.2d 242 (4th Dep't 1944). **Cf.** B.C.S. Corp. v. Colonial Discount Co., 169 Misc. 711, 713, 8 N.Y.S.2d 65, 67 (City Ct. 1938) (chattel mortgage).

[28] All of the cases considering this notice problem in the context of a bona fide sale transaction have held that the assignee's knowledge of the dealer's general practice to engage in trust receipt financing does not constitute notice that the particular automobile under the conditional sales contract is subject to a trust receipt lien. Commercial Credit Co. v. Barney Motor Co., 10 Cal. 2d 718, 76 P.2d 1181 (1938); Tharp v. San Joaquin Valley Securities Co., 20 Cal. App. 2d 20, 66 P.2d 230 (1937). **Cf.** Peoples Finance and Thrift Co. v. Bowman, 58 Cal. App. 2d 729, 137 P.2d 729 (1943).

between dealer and vendee and makes no further attempt to determine the nature of the sale and to discover whether the automobile is entrusted, his participation at least evidences a lack of good faith. When the claim arises out of a sale which was in fact fictitious, there should be a presumption of bad faith, rebuttable by a showing either that the assignee had no reason to suspect a close relationship between dealer and vendee, or that after exercising reasonable care the assignee could not discover both that the automobile was entrusted property and that the vendee was fictitious. This presumption is consistent with the policy of the UTRA, since it is premised not on the assignee's assumption of the risk of dealer dishonesty, but on the assignee's own bad faith in participating in the scheme when a reasonable financer would have made further inquiries.

If the entruster loses his claim to the conditional sales contract the extent of his recovery from a defaulting dealer may often depend on how his interest in unidentifiable proceeds is classified in federal bankruptcy proceedings. Proceeds which remain subject to the entruster's claim under section 10 of the UTRA are those realized by the dealer from the sale of entrusted goods or the assignment of consumer paper. When the dealer is in default it is likely that bankruptcy is imminent and that these cash proceeds are commingled with his other assets and are unidentifiable Under 10(b):

> ". . . the entruster [is] entitled, to the extent to which and as against all classes of persons as to whom his security interest was valid at the time of disposition by the trustee, . . . to any proceeds or the value of any proceeds (*whether such proceeds are identifiable or not*) of the goods, . . . if said proceeds were received by the trustee within ten days prior to either . . . the filing of a petition in bankruptcy . . . by or against the trustee, or demand made by the entruster for prompt accounting; *and to a priority to the amount of such proceeds or value.* . . ." [Emphasis added.]

If this section is interpreted to establish for the entruster only a priority in distribution of the dealer's assets it would be of no value since section 64 of the Bankruptcy Act eliminates state-created priorities.[29] The entruster as a priority holder would be relegated to the position of an unsecured creditor. If 10(b) creates a statutory lien within the meaning of section 67c of the Bankruptcy Act his claim would probably be similarly unsecured; section 67c(2) invalidates statutory liens on personalty not accompanied by "possession of" or by "levy upon" the property subject to the lien before filing of the petition in bankruptcy.[30] However, a third possibility is that section 10(b) authorizes a consensual lien which would entitle the entruster to first claim on the bankrupt's assets.

Section 10(b) does not create a statutory lien within the meaning of the Bankruptcy Act. Statutory liens are those not merely regulated, but created by statute for the benefit of particular economic classes.[31] Thus section 67b's protection of statutory lien holders is limited in application to liens in favor of "employees, contractors, mechanics, landlords or other classes of persons. . . ."[32] It is unlikely that the term "other classes of persons" is intended to include creditors, such as entrusters, whose security interest, even though regulated by statute, is ob-

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[29] 52 Stat. 874 (1938), as amended, 11 U.S.C. § 104 (1952); Halpert v. Industrial Comm'r, 147 F.2d 375 (2d Cir. 1945); Strom v. Peikes, 123 F.2d 1003 (2d Cir. 1941); 3 Collier, Bankruptcy ¶ 64.01, at 2052 (14th ed., Moore & Oglebay 1941) (hereinafter cited as Collier).

[30] 66 Stat. 428, 11 U.S.C. § 107(c)(2) (1952) (allowing the trustee in bankruptcy to preserve the lien for the benefit of the estate); 4 Collier ¶ 67.20 [5], at 195. In the Matter of Quaker City Uniform Co., 238 F.2d 155 (3d Cir. 1956) (original classification and invalidation of chattel mortgage as a statutory lien modified on rehearing; opinion reserved as to whether chattel mortgage creates statutory lien).

[31] 4 Collier ¶ 67.20[2], at 184.

[32] 30 Stat. 564 (1898), as amended, 11 U.S.C. § 107(b) (1952).

tained through a private agreement between the parties.[31] Congressional intent further indicates that security devices such as the trust receipt are not statutory liens. Section 67b exempts statutory liens from the voiding provisions of section 60.[34] This exemption would be illogical for extensively used inventory liens. In addition, section 60 was amended in 1950 to make trust receipts, among other security devices, less vulnerable to invalidation as preferential transfers; this amendment would have been unnecessary if 67b already preserved trust receipts liens.[35] It therefore seems clear that section 67b's protection of "statutory liens" does not extend to the entruster's claim under section 10(b). And, while it is possible that "statutory lien" has a different meaning in 67c, the Bank-

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[33] See In the Matter of Tele-Tone Radio Corp., 133 F. Supp. 739, 746-48 (D.N.J. 1955) (holding that factor's lien is not statutory; 4 Collier ¶ 67.20 [2], at 184-85 & n.16b (stating that the UTRA lien is not statutory). **But see In re** Rand Mining Co., 71 F. Supp. 724, 727 (S.D. Cal. 1947) (dictum that the UTRA lien is statutory); Hanna, **Preferences in Bankruptcy**, 15 U. Chi. L. Rev. 311, 320 (1948).

[34] 30 Stat. 564 (1898), as amended, 11 U.S.C. § 107(b) (1952).

[35] In 1950 § 60a(2) of the Bankruptcy Act was amended, 64 Stat. 24, 11 U.S.C. § 96(a) (1952), to change the standard by which the perfection of liens would be tested. Before this amendment, transfers were deemed to have occurred when they became so perfected that no bona fide purchaser from the dealer could create rights in the property superior to the rights of the transferee. Since the entruster may never obtain rights superior to that of a buyer from the dealer in the ordinary course of trade, UTRA § 9-2(a), the entruster's lien could never attain the required perfection. His lien was therefore deemed to have been transferred to the entruster on the eve of bankruptcy, which made the transfer "for or on account of an antecedent debt." The transfer was then vulnerable as a voidable preference. See Bankruptcy Act § 60a(1), b, 30 Stat. 562 (1898), as amended, 11 U.S.C § 96 (1952). When the transfer was voided, the entruster no longer had a lien to shield from the preferential transfer provisions any money or property received in repayment.

ruptcy Act suggests neither a different definition nor any reason for construing the 67c term differently.[35] The invalidating clauses of that section should not, therfore, apply to a section 10(b) lien.

The most reasonable interpretation is that section 10(b) of the UTRA authorizes a consensual lien on unidentifiable proceeds. Under the terms of this section the entruster is accorded the same rights in proceeds as he had in the goods; he is entitled to proceeds, identifiable or not, "*to the extent to which* and *as against all classes of persons* as to whom his security interest was valid at the time of disposition" of the goods by the dealer. The entruster's "security interest . . . at the time of disposition" has been held to be a consensual lien on the trust receipted

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In re Harvey Distributing Co., 88 F. Supp. 466 (E.D. Va. 1950), **rev'd sub nom.** Coin Mach. Acceptance Corp. v. O'Donnell, 192 F.2d 773 (4th Cir. 1951). This commercially undesirable result was a major reason for amending § 60(a) to substitute a judicial lien creditor test for that of a bona fide purchaser. The entruster, in most instances, obtains rights in property superior to that of a judicial lien creditor. Under this test, therefore, his lien may be so perfected by filing that the transfer of the security interest is deemed to have occurred at the time the trust receipt transaction created the debt. Coin Mach. Acceptance Corp. v. O'Donnell, **supra** at 776 (finding from the history of the 1950 amendment that Congress had originally intended the result prescribed by the amendment); see S. Rep. No. 72, 81st Cong., 1st Sess. 1, 3 (1949); Kupfer, **The Recent Amendment of Section 60(a) of the Bankruptcy Act**, 24 Ref. J. 86 (1950); MacLachlan, **Preference Redefined**, 63 Harv. L. Rev. 1390 (1950).

[35] See In the Matter of Tele-Tone Radio Corp., 133 F. Supp. 739 (D.N.J. 1955); Note, 69 Harv. L. Rev. 756 (1956). Classifying the UTRA lien as a statutory lien would produce further undesirable and arbitrary results. Since 67c(a) voids statutory liens unaccompanied by possession, the utility of all inventory devices, to which this holding would necessarily be applicable, would be impaired. Accordingly, repossession of inventory would be encouraged, deterring an orderly disposition of the bankrupt's estate. Note, 69 Harv. L. Rev. 756, 758 (1956).

goods;[37] the "classes of persons" as against whom this lien has been held valid includes the trustee in bankruptcy.[38] Hence, section 10(b) provides the entruster with a lien on unidentifiable proceeds intended to be enforceable in bankruptcy proceedings.[39]

The last clause of section 10(b), ". . . and to a priority . . .," should in no way weaken or obscure the entruster's rights.[40] In some instances a debt may be secured by a lien as well as entitled to a priority.[41] The last clause of section 10(b) was designed to effect just this result.[42] When the UTRA was promulgated in 1933 the Bankruptcy Act did recognize state-created priorities.[43] Not until

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[37] Taylor v. Quittner, 218 F.2d 549 (9th Cir. 1954); Chichester v. Commercial Credit Co., 37 Cal. App. 2d 439, 99 P.2d 1083 (1940); Donn v. Auto Dealers Inv. Co., 385 Ill. 211, 52 N.E.2d 695 (1944).

[38] Taylor v. Quittner, **supra** note 37; Chichester v. Commercial Credit Co., **supra**, note 37.

[39] In addition § 18 states that the provisions of the UTRA should be uniformly and consistently interpreted. Section 10(b) entitles the entruster to proceeds "whether . . . identifiable or not," and all relevant cases have held that the entruster has a lien on identifiable proceeds. Taylor v. Quittner, 218 F.2d 549 (9th Cir. 1954); Universal Credit Co. v. Citizens State Bank, 224 Ind. 1, 64 N.E.2d 28 (1945). Consequently, a uniform and consistent interpretation should require that the entruster's right to unidentifiable proceeds be given the same effect.

[40] In the Matter of Harpeth Motors, Inc., 135 F. Supp. 863 (M.D. Tenn. 1955) (overruling a referee's holding that § 10 provided a mere priority).

[41] See, e.g., Bankruptcy Act § 64a, 30 Stat. 563 (1898), as amended, 11 U.S.C. § 104(a) (1952); § 67b, 30 Stat. 564 (1898), as amended, 11 U.S.C. § 107(b) (1952); § 67c, 66 Stat. 428, 11 U.S.C. § 107(c) (1952) (rent, wages and tax claims may have both lien and priority); 3 Collier ¶ 64.02, at 2056 (discussing lien and priority of tax claims).

[42] The introductory conjunction "and" following a semicolon makes this clear. See page 928 **supra.**

[43] 30 Stat. 563 (1898) (later amended by 52 Stat. 874 (1938), 11 U.S.C. § 104 (1952)); see note 29 **supra** and accompanying text.

five years later did the Chandler Amendment invalidate them, causing the word priority to become a term of art.[44] In view of this historical background the obsolete usage employed in the last clause of 10(b) should not impair the lien conferred by the first part of this section. Furthermore, the standard distinction between a priority and a valid lien is that the former arises only upon bankruptcy, affording a narrow right to payment as a certain relative point in the distribution of a debtor's property, while the latter entains a right to enforcement independent of bankruptcy.[45] It is thus apparent that the first part of 10(b), giving the entruster a right to proceeds irrespective of bankruptcy if he makes a timely demand for prompt accounting, provides a lien rather than a priority.

Federal bankruptcy courts should be bound by this interpretation of state law which gives the entruster a lien on the value of proceeds. Section 70 of the Bankruptcy Act and interpretive comments provide that the trustee takes the property in the bankrupt's possession subject to all valid liens.[46] Nevertheless, the unique dimensions of the entruster's lien on proceeds may raise conceptual difficulties. Since 10(b) entitles the entruster to the "value" of proceeds,[47] he has a charge against the trustee in bankruptcy on any free assets of the dealer—assets that were not originally subject to the entruster's security interest. The novelty of this 10(b) lien has troubled some commentators. It has been argued that the entruster can claim the value of proceeds only as a reclamation petitioner, on the theory that he is the beneficiary

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[44] **Ibid.**

[45] 3 Collier ¶ 64.02, at 2055-56; In the Matter of Harpeth Motors, Inc., 135 F. Supp. 863 (M.D. Tenn. 1955) (quoting from Collier); cf. Note. 51 Yale L.J. 863, 868 (1942); Prudence Realization Corp. v. Geist, 316 U.S. 89 (1942).

[46] 30 Stat. 565 (1898), 11 U.S.C. § 110 (1952); 4 Collier ¶ 70.04, at 947 & n.20 (collecting cases).

[47] See page 928 **supra.**

of a trust.[48] If this were true, standard trust law would require that the entruster identify and trace proceeds of sale.[49] The proceeds are often cash, and it may be impossible to trace them into a particular bank account or newly acquired property. However, the UTRA clearly dispels the trust analogy. Section 1 declares that "[t]he use of the word 'Trustee' . . . shall not be interpreted or construed to imply the existence of a trust . . ."; section 10(b) eliminates any identification requirement.[50] In bankruptcy proceedings state law is determinative as to the existence of a trust and tracing requirements, unless it substantially departs from the general norm of trust law.[51] Certainly the provisions of a uniform law adopted in thirty-one states cannot be considered aberrational and should be followed by federal bankruptcy courts.[52] More-

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[48] Gilmore, **Chattel Security, II,** 57 Yale L.J. 761, 768 (1948) suggests that the trust analogy may be necessary to support the entruster's claim to proceeds. See also In the Matter of Harpeth Motors, Inc., 135 F. Supp. 863, 869 (M.D. Tenn. 1955) (disagreeing with, although not overruling, the referee's contention that the entruster's claim could not be enforced unless he traced proceeds of sale).

[49] 4 Collier ¶ 70.25 at 1134; 4 Scott, Trusts § 521 (2d ed. 1956).

[50] In the Matter of Harpeth Motors, Inc., 135 F. Supp. 863, 869 (M.D. Tenn. 1955); Heindl, **Trust Receipt Financing Under the Uniform Trust Receipts Act,** 26 Chi.-Kent L. Rev. 197, 258 (1948); Bogert, **The Effect of the Trust Receipts Act,** 3 U. Chi. L. Rev. 26, 37 (1935).

[51] Even though Congress might preempt state law in this area, it has not done so, 4 Collier ¶ 70.25, at 1148-49. Bankruptcy courts, consequently, must refer to state law on these questions. **Ibid.** They may, however, overrule any state law which, if applied, would effect a state insolvency rule rather than the bankruptcy rule of distribution. **Ibid.** See **In re** Tate-Jones & Co., 85 F. Supp. 971 (W.D. Pa. 1949) (citing Collier); **cf.** Prudence Realization Corp. v. Geist, 316 U.S. 89 (1942).

[52] See note 51 **supra.** By enacting the 1950 amendments to § 60, Congress has, in fact, evidenced an intent to use its bankruptcy power to preempt state rules on trust receipts. See note 35 **supra.**

over, normally state law, not the Bankruptcy Act, also determines what liens are valid, for the act nowhere states any affirmative requirements of a valid lien.[53] It is true that liens defined as valid by state law often are, or lead to transfers of property interests which may be voidable under the Bankruptcy Act's express provisions against preferential and fraudulent transfers.[54] But the entruster can meet these requirements by filing under the UTRA.[55] When he does, the Bankruptcy Act imposes no further obstacle to a section 10(b) lien on free assets of the bankrupt dealer.[56]

The validity of the UTRA lien on the value of proceeds, however, should be conditioned on the entruster's prompt prosecution of his claim.[57] Section 10 makes the

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[53] 4 Collier ¶ 70.70, at 1343-47 (collecting cases).

[54] See Bankruptcy Act § 60a, b, 30 Stat. 562 (1898), 11 U.S.C. § 96(a)(b) (1952); § 67d, 30 Stat. 564 (1898), 11 U.S.C. § 107(d) (1952); § 70c, 30 Stat. 566 (1898), 11 U.S.C. § 110(c) (1952); § 70e, 30 Stat. 566 (1898), 11 U.S.C. § 110(e) (1952).

[55] If the entruster's security interest is valid under the UTRA and he has properly filed, it may not be avoided under: § 67d (provided the entruster has given fair consideration); § 70c, 4 Collier ¶ 70.58, at 1307; § 70e, 4 id. ¶ 70.85; or § 60a, 4 id. ¶ 70.58, at 1308 & n.27a, and see note 35 supra. See also 3 Collier ¶ 60.45, at 958-59 (discussing whether filing must take place within twenty-one days after transaction under § 60a(7), or within thirty days under UTRA §§ 7, 8, 9; Note, 66 Yale L.J. 567, 575 & n.40 (1957) (same).

[56] 4 Collier ¶ 70.70, at 1344-46 (collecting cases).

[57] Dealers often take used cars from customers as part of the retail price of entrusted automobiles. When the dealer fails to repay his entire debt on the new car, the entruster should be permitted to maintain a security interest in this type of proceeds without immediately prosecuting his claim only if he secures a chattel mortgage, a new trust receipt (in states where this is possible), or some other security device on the used automobile.

entruster's demand for a prompt accounting within ten days of sale necessary for the preservation of his security interest.[58] A demand for prompt accounting has been held to mean that the entruster must demand immediate de-

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[58] Although the period of time during which the entruster's lien on proceeds survives before he demands an accounting ostensibly varies under § 10(a), § 10(b), and § 10(c), it is unlikely that § 10(a) or § 10(c) will be interpreted to permit the entruster to remain safety inactive for appreciably longer than the ten day limit of § 10(b). The effect of this time limit is to force the entruster to police the dealer's activities diligently. Section 10 (c) may seem to extend this time limit when the proceeds of sale are identifiable. The entruster is held to a waiver of his security interest if he fails to demand an accounting within ten days after his "knowledge" that such proceeds existed. But, since the entruster is forced to maintain constant surveillance over the dealer in order to preserve his security interest in unidentifiable proceeds, he will probably be held to as least constructive knowledge of the existence of identifiable proceeds shortly after they are received by the dealer.

Section 10(a), which gives the entruster a security interest in debts owing to the dealer by reason of the sale of collateral, apparently does not condition this right upon any affirmative action by the entruster. This section becomes important in the rather unusual occurrence of a dealer retaining a conditional sales contract. The entruster may then attempt to claim this form of identifiable proceeds under § 10(a) and subsequently claim the installment payments without showing that he made a timely demand for an accounting after the dealer initially received this consumer paper. Since the Commissioners' Prefatory Note, 9A U.L.A. 282, explains that the act "deprives the entruster of the altogether improper possibility of acting like a mere creditor while things go well, but insisting on his rights . . . if thing go badly," it is quite unlikely that § 10(a) was intended to permit the entruster to act "like a mere creditor" indefinitely. The most reasonable conclusion, consequently, is that the general ten day period common to §§ 10(b) and (c) is applicable to the entruster's rights under § 10(a) as well.

livery of the proceeds from the dealer.[59] But neither the UTRA nor case law has considered whether the entruster's lien should be contingent upon any further action if the dealer fails to comply with this demand. The most reasonable construction of the demand for accounting requirement would necessitate that the entruster diligently bring suit for the proceeds upon the dealer's default or lose his security interest in them. Since a creditor knows that cash proceeds are easily dissipated in the course of business, the entruster who permits a dealer to continue business without promptly enforcing his lien, depends, just as any unsecured creditor, on the dealer's honesty and continued solvency rather than on his collateral. Thus he should be placed in no better position than unsecured creditors in bankruptcy and nonbankruptcy proceedings. In either type of proceeding failure to sue immediately after a prompt demand for an accounting should dissolve the entruster's lien, except if a petition in bankruptcy was filed by or against the dealer within ten days after sale.[60] Outside of bankruptcy, if an unsecured creditor effects a prior attachment on property of the dealer, the entruster should be compelled to take effective action adverse to that creditor's interest in order to maintain a superior lien on this property.[61]

Once the entruster's lien on the value of cash proceeds is conditioned on his diligent enforcement it is not at all inequitable to accord him the favored status of a secured creditor. Because the entruster is usually the dealer's most significant creditor, in terms of importance to the business and of dollar amount, the substantial risks of dealer insolvency lie with him rather than with

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[59] Peoples Finance and Thrift Co. v. Bowman, 58 Cal. App. 2d 729, 734-35, 137 P.2d 729, 731-32 (1943).

[60] See UTRA § 10(b), **supra** page 928.

[61] Such action may include intervening in the other creditor's suit (in states where possible, Clark, Code Pleading 420-23 (2d ed. 1947)), enjoining the other creditor's action, or bringing a bill to marshal the liens and sell the property.

the unsecured creditors.[62] For this reason the entruster takes a number of measures to protect his interest. He gives notice of his claim by recording a statement of inventory financing[63] and conducts an extensive examination into the business background of the dealer.[64] He arranges for regular physical inspections of the dealer's trust receipted inventory, which are itensified if signs of trouble ae disclosed,[65] and makes a prompt demand for repayment each time collateal is sold.[66] The unsecure creditors, on the other hand, do not customarily take any of these precautions. Moreover, the entruster has entered into the financing arrangement relying ultimately for payment upon his security interest in the value of proceeds. He expects to be paid an amount equal to the wholesale cost of the goods from the proceeds of sale, whereas the unsecured creditors can expect satisfaction only from the mark-up retained by the dealer. Thus if unsecured creditors have depended upon any specific part of the dealer's assets it has been on net receipts—income above cost of goods sold—rather than on gross receipts which, to the greatest extent, have been made possible by the entruster. Therefore, since the entruster does lose his lien on the goods themselves,[67] and should lose his claim to a conditional sales contract taken in good faith by another finance company,[68] he should be accorded a security interest in the value of proceeds upon which he has relied and against which he has diligently proceeded.

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[62] See Hanna, **Preferences in Bankrupcty**, 15 U. Chi. L. Rev. 311, 314-15 (1948).

[63] See note 4 **supra.** But see Note, 66 Yale, L.J. 567, 574 & n.31 (1957) (collecting authorities which question the value of notice filing).

[64] Siedman, Finance Companies and Factors 104-06 (1949).

[65] See **id.** at 97-98; Heindl, **supra** note 50, at 259.

[66] See note 58 **supra.**

[67] UTRA § 9-2(a).

[68] See notes 15-28 **supra** and accompanying text.

APPENDIX H.

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March 18, 1960

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Mr. Edward P. McKeown,
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Dear Mr. McKeown:

Re: James J. English, as Trustee in Bankruptcy of the Estate of Russell E. Lowell, Inc., a Florida corporation, versus Universal CIT Credit
Universal CIT Credit Corporation, a West Virginia corporation, authorized to transact business in the State of Florida.

No. 18,013

Please be advised that the above case was argued in the United States Court of Appeals, Fifth Circuit, on March 7, 1960. As soon as an opinion is received, I will forward you a copy.

Yours very truly,
/s/ James A. Dixon

JAD:K